

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-07 IO-13 ISO-00 AID-05 CIAE-00

COME-00 FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02

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R 190716Z AUG 76

FM AMEMBASSY CANBERRA

TO SECSTATE WASHDC 8781

USDEL MTN GENEVA

AMEMBASSY JAKARTA

AMCONSUL MELBOURNE

USMISSION OECD PARIS

AMEMBASSY PORT MORESBY

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LIMITED OFFICIAL USE SECTION 1 OF 2 CANBERRA 6002

SYDNEY ALSO PASS TRADE CENTER

CINCPAC FOR POLAD

E.O. 11652: N/A

TAGS: ECRP, EGEN, EFIN, AS

SUBJECT: FY 77 AUSTRALIAN FEDERAL BUDGET

REF: (A) CANBERRA 5968, (B) CANBERRA 5848, (C) CANBERRA 5624
(D) CANBERRA 3714, (E) 75 CANBERRA 5630

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1. SUMMARY: GOA TREASURER LYNCH PRESENTED FINANCIAL YEAR
1976-77 (FY 77) BUDGET AT OPENING OF PARLIAMENT ON AUGUST 17.
HE DESCRIBED BUDGET AS ON WHICH WOULD "TURN BACK THE RECENT
TREND TOWARDS BIGGER AND BIGGER GOVERNMENT", AND EMPHASISE

AS GOVERNMENT'S "FIRST PRIORITY THE ABSOLUTE NECESSITY TO COMBAT INFLATION." OVERALL PROJECTED DEFICIT OF JUST OVER \$2.6 BILLION (ALL DOLLAR FIGURES ARE AUSTRALIAN DOLLARS; CURRENT PARITY IS \$A1.00 EQUALS \$US1.24). OUTLAYS TO INCREASE 11.3 PERCENT, REPRESENTING A SLIGHT DECLINE IN REAL TERMS. RECEIPTS ARE TO INCREASE 18.8 PERCENT. DEFENSE SPENDING RISES 17.6 PERCENT AND SHARE OF BUDGET, QT 8.95 PERCENT INCREASES SLIGHTLY OVER FY 76. PHASE OUT OF COAL EXPORT LEVY WILL BEGIN AND \$2 PER BARREL PRODUCTION TAX ON CRUDE OIL IS ELIMINATED FOR NEWLY-DISCOVERED CRUDE. SIGNIFICANT TAX CONCESSIONS ANNOUNCED FOR MINING INDUSTRY/ PERSONAL INCOME TAX INDEXATION CONFIRMED AS IN EFFECT SINCE JULY 1. FIRST STEPS IN PHASE-IN OF CORPORATE INCOME TAX INDEXATION THROUGH INVENTORY VALUATION PROCEDURES ANNOUNCED. UNDER STAGE 1 OF GOVERNMENT "TAX SHARING SCHEME" STATES WILL BE ENTITLED TO 33.6 PERCENT OF COMMONWEALTH PERSONAL INCOME TAX COLLECTIONS (ABOUT \$3.7 BILLION IN FY 77). LOCAL GOVERNMENT WILL ALSO HAVE AN ANNUAL ENTITLEMENT. LYNCH STATED STATES WILL RECEIVE APPROXIMATELY \$89 MILLION MORE THAN THEY WOULD HAVE UNDER OLD GRANTS SCHEME. SPECIFIC PURPOSE PAYMENTS TO STATES EXPECTED TO RISE ABOUT 9 PERCENT IN FY 77, A REDUCTION IN REAL TERMS. BUDGET APPEARS DECIDELY DEFLATIONARY AND ITS OVERALL SUCCESS WILL DEPEND ON EXTENT TO WHICH IT LEADS TO REDUCTION IN OVERALL INFLATION RATE AND TO WHICH THIS IN TURN MOTIVATES PRIVATE SECTOR TO RAISE CONSUMPTION AND INVESTMENT. END SUMMARY.

2. AGGREGATES. OUTLAYS ESTIMATED AT \$24.32 BILLION, AN 11.3 PERCENT INCREASE OVER FY 76. RECEIPTS EXPECTED TO TOTAL \$21.7 BILLION, 18.8 PERCENT UP ON FY 76. OVERALL DEFICIT \$2.6 BILLION, WITH DOMESTIC DEFICIT PEGGED AT \$1.88 BILLION. OVERALL DEFICIT DOWN \$977 MILLION FROM ACTUAL FY 76 FIGURE, WHILE DOMESTIC DEFICIT DOWN \$1 BILLION. ON BASIS OF PRESENT ESTIMATES, TOTAL GOVERNMENT OUTLAYS AS PROPORTION OF GDP EXPECTED TO AROUND 30 PERCENT (PERHAPS SLIGHTLY LESS), AS AGAINST 31.4 PERCENT IN FY 76. TREASURY STATEMENT LIMITED OFFICIAL USE
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INDICATES THAT GOVERNMENT'S DECISION IMPLEMENT NEW FAMILY ALLOWANCES SCHEME ON JULY 1 (CANBERRA 3714) IS ESTIMATED TO ADD CLOSE TO \$800 MILLION TO BUDGET OUTLAYS IN FY 76. EFFECTS OF THIS DECISION ARE EXPECTED TO BE LARGELY -- THOUGH NOT ENTIRELY -- OFFSET BY PROPOSED BORROWING BY AUSTRALIAN TELECOMMUNICATIONS COMMISSION OUTSIDE BUDGET (\$200 MILLION), EXPECTED LARGE REPAYMENTS BY AUSTRALIAN WOOL CORPORATION AND LARGE PREPAYMENTS MADE TO STATES IN JUNE IN RESPECT TO HOSPITAL OPERATING COSTS IN SEPTEMBER 1976 QUARTER.

3. FUNCTIONAL OUTLAYS AND PERCENTAGES OF INCREASE OR DECREASE OVER FY 76 ARE AS FOLLOWS (IN MILLIONS): DEFENSE, \$2,178, 17.6 PERCENT; EDUCATION, \$2,204, 15.3 PERCENT;

HEALTH, \$2,909, -1.5 PERCENT; SOCIAL SECURITY AND WELFARE, \$6,187, 23.5 PERCENT; HOUSING, \$568, 1 PERCENT; URBAN AND REGIONAL DEVELOPMENT NEC AND ENVIRONMENT, \$256, -37.2 PERCENT; CULTURE AND RECREATION, \$254, 0.2 PERCENT; ECONOMIC SERVICES, \$1,563, -23.8 PERCENT; GENERAL PUBLIC SERVICES, \$1,634, 12.7 PERCENT; NOT ALLOCATED TO FUNCTION, \$6,568, 21.6 PERCENT. DECLINE IN ECONOMIC SERVICES REFLECTS NET EFFECT OF TELECOM AUSTRALIA LOAN AND EXPECTED REPLY MENT FROM AUSTRALIAN WOOL CORPORATION. DECLINE IN HEALTH SERVICES EXPENDITURE REFLECTS CHANGES IN MEDIBANK FINANCING AND PREPAYMENTS TO STATES. LARGE INCREASES WITH RESPECT TO "NOT ALLOCATED TO FUNCTION" CATEGORY ARE ATTRIBUTABLE MAINLY TO A RAPID INCREASE IN ESTIMATED PAYMENTS ON DEBT CHARGES.

4. ON REVENUE SIDE FOLLOWING MAJOR PROJECTIONS HAVE BEEN MADE, WITH PERCENTAGE INCREASE OR DECREASE OVER FY 76 (IN MILLIONS): IMPORT DUTIES, \$1,110, 19.1 PERCENT; COAL EXPORT LEVY, \$112.0, 0.36 PERCENT; EXCISE DUTY, \$2,510, 7.6 PERCENT; SALES TAX, \$1,700, 20.7 PERCENT; PAY-AS-YOU-GO (PAYE) INCOME TAX, \$8,775, 25 PERCENT; OTHER PERSONAL INCOME TAX, \$2,532, 15.1 PERCENT; CORPORATE INCOME TAX, \$2,900, 15 PERCENT; (TOTAL GENERAL TAXATION REVENUE, \$19,957, 18.5 PERCENT); RECEIPTS BY GOVERNMENT ON INTEREST, RENT AND DIVIDENDS, \$1,632, 16.1 PERCENT.

5. OF SPECIAL INTEREST

A. DEFENSE SHARE: SHARE OF DEFENSE EXPENDITURES IN TOTAL BUDGET SLIGHTLY REVERSED DECLINING TREND IN PREVIOUS LIMITED OFFICIAL USE
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YEARS AND ARRIVED AT 8.95 PERCENT COMPARED TO ACTUAL OUTLAYS OF 8.47 PERCENT IN FY 76. SHARE IS, HOWEVER, STILL WELL BELOW LEVELS OF 9.1 PERCENT IN FY 76 AND 10.8 PERCENT IN FY 74. ABSOLUTE INCREASE WAS 17.6 PERCENT. OF 325 MILLION INCREASE, 88.5 MILLION (27.2 PERCENT) IS FOR MANPOWER, \$178.1 MILLION (54.7 PERCENT) FOR GENERAL EQUIPMENT AND STORES, \$18.3 MILLION (5.6 PERCENT) FOR DEFENSE FACILITIES AND \$4.8 MILLION (1.5 PERCENT) FOR DEFENSE SCIENCE AND TECHNOLOGY ESTABLISHMENTS. EXPENDITURES FOR "DEFENSE COOPERATION" WILL BE \$23.9 MILLION, A REDUCTION OF \$15 MILLION (38.7 PERCENT) OVER FY 76.

B. FOREIGN AID: TOTAL AID PAYMENTS ESTIMATED TO INCREASE 14.6 PERCENT TO \$399.4 MILLION. OF THIS TOTAL, \$228.1 MILLION, OR 67.2 PERCENT, IS DESTINED FOR PAPUA NEW GUINEA. LYNCH ALSO MENTIONED THAT AN ESTIMATED \$26 MILLION WILL FLOW TO INDONESIA IN FY 77, BEING THE FIRST YEAR OF A NEW THREE YEAR AID PROGRAM FOR THAT COUNTRY OF \$86 MILLION. OF MULTILATERAL AID TOTAL OF \$60 MILLION, LION'S SHARE WILL GO THROUGH INTERNATIONAL DEVELOPMENT FINANCIAL INSTITUTIONS (\$40.5 MILLION OR 67.5 PERCENT) AND UN PROGRAMS (\$10.9

MILLION OR 18.1 PERCENT), WITH THE BALANCE GOING THROUGH REGIONAL AND OTHER ORGANIZATIONS.

C. INDUSTRY ASSISTANCE AND DEVELOPMENT: THIS ITEM TO DECLINE \$220 MILLION OR 62.6 PERCENT AS COMPARED TO FY 76 IN NET TERMS. BIGGEST DECLINES OCCUR IN WOOL MARKETING PRICE SUPPORT (DOWN \$214 MILLION), RESEARCH PROMOTION AND OTHER EXPENDITURE (DOWN 208.4 MILLION), AND MANUFACTURING INDUSTRY (DOWN \$68.7 MILLION). ON THE OTHER HAND, EXPORT AND TLODE PROMOTION EXPENDITURES TO INCREASE BY 7.5 PERCENT TO 15.7 MILLION.

D. AIR TRANSPORT: AS PREVIOUSLY REPORTED (CANBERA 3714), AIR NAVIGATION CHARGES WILL INCREASE BY 15 PERCENT EFFECTIVE DECEMBER 1. THIS EXPECTED BRING INCREASE IN REVENUES OF \$4 MILLION IN FY 77 AND \$8 MILLION FOR FULL YEAR. ON OTHER HAND, LYNCH STATED THAT "WE ARE ALSO IMPLEMENTING ECONOMIES WHICH, WITHOUT ADVERSE EFFECTS ON SAFETY WILL RESULT IN EXPENDITURES ON CIVIL AVIATION FACILITIES AND SERVICES IN FY 77 BEING LOWER, IN REAL TERMS, THAN IN FY 76." IN FACT, LIMITED OFFICIAL USE
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IT ESTIMATED EXPENDITURES FOR CIVIL AVIATION SERVICES WILL BE DOWN \$17.2 MILLION (-19.8 PERCENT) IN FY 77.

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R 190716Z AUG 76
FM AMEMBASSY CANBERRA
TO SECSTATE WASHDC 8782
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E. COAL EXPORT LEVY: IN LINE WITH EMBASSY SPECULATION
IN CANBERRA 5624, LYNCH ANNOUNCED THAT GOVERNMENT OPPOSED TO
CONCEPT THIS LEVY AND THAT IT WOULD BEGIN PHASED REDUCTION
BY REMOVING DUTY COMPLETELY FROM NON-COKING COAL AND REDUCING
RATE 25 PERCENT ON COKING COAL -- FROM \$6 TO \$4.50 PER METRIC
TON FOR HIGHER RATE AND FROM \$2 TO 1.50 FOR LOWER RATE.

F. CRUDE OIL LEVY: STATING THAT \$2 PER BARREL
PRODUCTION LEVY REPRESENTS A "SUBSTANTIAL DETERRENT TO
EXPLORATION," LYNCH ANNOUNCED THAT "OIL FROM DISCOVERIES
AFTER TODAY WILL BE FREE FROM PRODUCTION EXCISE," AND THAT
AS RESULT, "ALL PRODUCTION OF CRUDE OIL FROM FUTURE
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DISCOVERIES WILL RECEIVE FULL IMPORT PARITY AT THE NEAREST
REFINERY PORT."

G. INCOME FROM MINING: FOLLOWING CHANGES IN INCOME TAX
ARRANGEMENTS IN RELATION MINING ANNOUNCED: (1) PETROLEUM
EXPLORATION EXPENDITURE AND ALLOWABLE CAPITAL EXPENDITURE ON
THE MINING OF PETROLEUM WILL BE DEDUCTIBLE AGAINST INCOME
FROM ANY SOURCE; (2) ALLOWABLE CAPITAL EXPENDITURE OF ANY
MINING COMPANY ON THE DEVELOPMENT OF A MINE OR FIELD WILL BE
DEDUCTIBLE ON A DIMINISHING VALUE BASIS, AS AT PRESENT, BY
REFERENCE TO A MAXIMUM LIFE OF MINE OR FIELD OF FIVE YEARS,
INSTEAD OF 25 YEARS AS AT PRESENT; (3) ALLOWABLE CAPITAL
EXPENDITURE ON FACILITIES USED FOR THE TRANSPORTATION OF
MINERALS, INCLUDING PETROLEUM, WILL NOW BE DEDUCTIBLE ON A
STRAIGHT LINE BASIS OVER EITHER 20 YEARS, AS AT PRESENT, OR
10 YEARS AT THE TAX PAYER'S OPTION TO BE EXERCISED WITH THE
FIRST CLAIM FOR DEDUCTION; (4) THE CATEGORIES OF EXPENDITURE
COVERED BY PRESENT PROVISIONS GIVING DEDUCTIONS FOR ALLOWABLE
CAPITAL EXPENDITURES ON MINERAL TRANSPORT FACILITIES WILL
BE EXTENDED TO COVER EXPENDITURES ON PORT DEVELOPMENT, SUCH
AS HARBOR SURVEYS, INITIAL DREDGING, NAVIGATIONAL AIDS AND
BREAKWATERS.

H. CORPORATE INCOME TAX-VALUATION OF INVENTORY:
GOVERNMENT HAS TAKEN FIRST STEP TOWARD EVENTUAL FULL IMPLE-
MENTATION OF CORPORATE INCOME TAX INDEXATION PROPOSALS PUT
FORTH BY MATTEWS COMMITTEE. SPECIFICALLY, AS OF JULY 1,
1976 COST OF A FIRM'S INVENTORY WILL BE REVALUED FOR INCOME
TAX PURPOSES BY REFERENCE TO PERCENTAGE INCREASE IN "GOODS"

COMPONENT OF CPI BETWEEN JUNE QUARTER 1976 AND JUNE QUARTER 1977. ADJUSTMENT WILL REDUCE TAX, NOT DEFER IT. AS PART OF PHASE-IN PROCESS, ONLY 50 PERCENT OF FULL ADJUSTMENT WILL BE ALLOWED NEXT YEAR AS DEDUCTIONS FROM FY 77 INCOMES.

I. INDIRECT TAXES: AS EMBASSY SPECULATED IN CANBERRA 5848, LYNCH ANNOUNCED THAT THERE WOULD BE NO RPT NO INCREASES IN MAJOR INDIRECT TAXES. HE CONTRASTED THIS ACTION WITH INCREASES IN FY 76 BUDGET WHICH REPRESENTED ADDITIONAL LEVIES TOTALING \$602 MILLION.

J. ECONOMIC OUTLOOK: LYNCH STTED THAT BUDGET AND OTHER LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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MEASURES DESIGNED BRING ABOUT GROWTH IN BROADLY DEFINED VOLUME OF MONEY (M3) IN 10-12 PERCENT RANGE DURING FY 77, THUS HELPING "ALLAY FEARS OF EITHER EXCESSIVE FINANCIAL TIGHTNESS OR FINANCIAL EASE." ALTHOUGH ATTACHING A CAVEAT THAT MUCH DEPENDED ON FUTURE WAGE DECISIONS OF CONCILIATION AND ARBITRATION COMMISSION AND DEGREE OF ACCEPTANCE BY ACTU, LYNCH PREDICTED THAT BY END OF FY 77 INFLATION "SHOULD BE DOWN TO SINGLE DIGIT RATES." ALTHOUGH ADMITTING THAT SEASONAL CONDITIONS WILL PREVENT OVERALL GROWTH IN FARM SECTOR, GOVT PREDICTS GROWTH IN GROSS NON-FARM PRODUCT OF ABOUT 4 PERCENT IN REAL TERMS IN FY 77. PREDICTIONIFARE FOR "ONLY A GRADUAL REDUCTION IN RATE OF UNEMPLOYMENT, WITH LITTLE IF ANY OF THIS APPEARING IN CALENDAR YEAR 1976." PREDICTED RECEIPTS FROM PAYE PERSONAL INCOME TAX COLLECTIONS ESTIMATED ON BASIS OF INCREASE OF 12 PERCENT IN AVERAGE EARNINGS AND 1.5 PERCENT IN AVERAGE LEVEL OF EMPLOYMENE(BOZH EXPRESSED IN TERMS OF MALE UNITS).

7. ANALYSIS OF BUDGET SHLULD NOT FACT THAT PROJECTED DEFICIT OF A\$3.6 BILLION NOT STRICTLY COMPARABLE WITH A\$3.6 BILLION DEFICIT REPORTED FOR 1976. TO PLACE THE TWO DEFICIT FIGURES ON COMPARABLE BASIS ADJUSTMENT WOULD HAVE TO BE MADE FOR THE A\$200 MILLION OF 1977 HOSPITAL EXPENSES PREPAID TO THE STATE GOVERNMENTS IN FISCAL 1976 AS WELL AS THE FACT THAT THE NEW BUDGET CALLS FOR TELECOM AUSTRALIA TO RESORT TO THE PRIVATE CAPITAL MARKET TO FINANCE A\$200 MILLION OF CAPITAL EXPENDITURE WHICH IN PAST YEARS WAS INCLUDED IN GOA BUDGET. THESE AND A FEW SMALLER EXAMPLES OF THE SAME TYPE OF ADJUSTMENT SUGGEST THAT ON A STRICTLY COMPARABLE BASIS THE DEFICIT HAS BEEN REDUCED BY APPROXIMATELY A\$500 MILLION RATHER THAN A\$1 BILLION FROM LAST YEAR'S LEVEL. END UNCLASSIFIED

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8. COMMENT: THE 1977 BUDGET FAITHFULLY AND RIGOROUSLY ADHERES TO THE GOVERNMENT'S PAST STRATEGY OF CONTRACTING THE

PUBLIC SECTOR, REDUCING THE DEFICIT AND RELYING HEAVILY ON
THE PRIVATE SECTOR TO FURNISH THE STIMULUS TO TAKE UP THE
RESOURCES RELEASED IN THE PROCESS. THE BUDGET CURBS PUBLIC
EXPENDITURE TO A POINT WHICH MAY INVOLVE A MARGINAL
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REDUCTION IN THE REAL LEVEL OF SPENDING AND ACCEPTS A
CONTINUATION AND POSSIBLE MARGINAL INCREASE IN UNEMPLOYMENT
DURING THE COMING YEAR. A KEY GOVERNMENT PREMISE IS THAT
THE PRINCIPAL OBSTACLE TO REVIVED CONSUMER DEMAND IS
FEAR OF INFLATION ANEYTHAT DEMONSTRATED PROGRESS AGAINST
INFLATION DURING 1977 WILL LEAD TO REDUCED PERSONAL SAVINGS,
INCREASED DEMAND AND CONSEQUENTIAL BUSINESS REVIVAL. THE
QUESTION THEREFORE WHICH OVERHANGS THIS BUDGET IS WHETHER
(1) THE GOVERNMENT'S COURSE OF FISCAL AUSTERITY IS WRONG OR
(2) WHETHER IT IS MERELY TAKING LONGER TO BEAR FRUIT THAN
WAS ORIGNALLY HOPED.

9. THE CLOSEST THING TO ANY STIMULUS IN THE BUDGET IS THE
PACKAGE OF TAX AND EXCISE INCENTIVES FOR THE EXTRACTIVE
INDUSTRIES, AND THE PARTIAL STEP TOWARD INDEXATION OF
CORPORATE TAXES. IN ADDITION, THE INDEXATION OF PERSONAL
INCOME TAX PLACES ADDITIONAL MONEY IN THE HANDS OF EMPLOYED
WAGE EARNERS, ALTHOUGH THIS IS POTENTIALLY OFFEST BY THE
GOVERNMENT'S PRESSURE FOR CONTINUATION OF ONLY PARTIAL
INDEXATION OF WAGES IN AN AVOWED ATTEMPT TO REDUCE REAL WAGE
RATES.

10. GIVEN THE LARGE AMOUNT OF SLACK IN THE AUSTRALIAN ECONOMY,
WE BELIEVE A SERIOUS CASE COULD HAVE BEEN MADE FOR CAREFULLY
SELECTED MEASURES OF STIMULATION IN THIS BUDGET. WE BELIEVE
CONSUMER EXPENDITURE MAY BE INHIBITED AS MUCH OR MORE BY
UNCERTAINTLY OVER THE UNEMPLOYMENT LEVEL ASBY THE TREND
OF INFLATION. IF THIS IS THE CASE, THE PROSPECT FOR A
REVIVAL OF CONSUMER DEMAND AND BUSINESS ACTIVITY DURING
1977 SEEMS UNCERTAIN WHILE IN THE ABSENCE OF SUCH A
REVIVAL, THE SHORT RUN EFFECT OF THE TAX CONCESSIONS MAY BE
VERY SMALL. MEANWHILE, THE GROWING BUSINESS CONCERN OVER THE
VERY SLOW PACE OF RECOVERY AND POPULAR CONCERN OVER
CONTINUING HIGH UNEMPLOYMENT, LIKELY TO BE COMPOUNDED AS
THIS YEAR'S CROP OF SCHOOL-LEAVERS ENTERS THE
EMPLOYMENT MARKET NEXT JANUARY, MAY CREATE IRRESISTIBLE
PRESSURES FOR A MODIFICATION OF THE HARD-NOSED APPROACH
EMBODIED IN THE AUGUST 17 BUDGET.
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